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SUBJECT: PANAMA CANAL EXPANSION HURDLES

This Part II of a two part series on the canal expansion.  
Part II discusses the legal, financial and economic  
implications of the referendum.

11. SUMMARY (SBU) Financing the canal expansion is premised on increasing tolls an average of 3.5% per year. Panama Canal Authority (ACP) officials are concerned that countries will use Article 5 of GATT (Freedom of Transit) and Article 3 of the Panama Canal Neutrality Treaty to oppose the planned toll increases. While there is no jurisprudence on the matter, the ACP faced objections to toll increases based on Article 5 of GATT in 2002 from a variety of countries. The objections were eventually withdrawn. The proposed budget and benefits of the expansion continue to be questioned by a former ACP administrator. The GOP continues to sell the expansion as a cure all for Panama's social and economic problems. END SUMMARY.

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New Legal Hurdles Uncovered  
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12. (U) The ACP seeks to double its tolls over the next 20 years. The current plan is to begin toll increase immediately following approval of the referendum by 3.5% per year. Frontloading the toll increases to as much as 8.0% per year in the first few years is also under consideration. As in the past, the increases will be instituted through a 30-day consultation period with the canal's users.

13. (SBU) Article 5 (Freedom of Transit) of the 1947 GATT Treaty (incorporated by reference into the 1994 GATT Treaty which is now part of the WTO system) provides that all charges and regulations imposed by contracting parties on traffic in transit to and from the territories of other contracting parties shall be reasonable, having regard to the conditions of the traffic. GATT Article 5 further provides that all transit duties or other charges imposed in respect of transit shall be limited to charges for transportation or those commensurate with administrative expenses entailed by transit or with the cost of services rendered. In short, ACP officials believe certain countries, such as Ecuador, Chile, the United States and various European countries, believe GATT Article 5 prohibits the ACP from raising tolls to fund the canal expansion or to fund GOP expenditures through the ACP remittances. According to ACP lawyers, there is no legal precedence on this issue. ACP lawyers told members of the Panamanian Association of Business Leaders (APEDE) at a meeting EconOff attended on June 27 that they believe that as a practical matter GATT Article 5 would not impede toll increase because they could be cast in a different light. However, ACP lawyers said that when the ACP previously announced toll increases many countries referenced GATT Article 5 as a prohibition against raising tolls beyond the costs of rendering the service. Eventually, according to ACP

lawyers, most countries withdrew their objections, except for Chile and Ecuador.

¶4. (SBU) Article 3 of the Panama Canal Neutrality Treaty provides that all tolls and other charges for transit and ancillary services shall be just, equitable and consistent with the principles of international law. The Understandings section of the Neutrality Treaty states that before any tolls can be increased the effect on the trade pattern of the United States and Panama must be given full consideration. Again, according to ACP lawyers, this is an area with little legal precedent. Despite various toll increases, certain ACP officials and business community members are concerned that the USG or U.S. companies may use the Neutrality Treaty as a way to halt or reduce any toll increases.

¶5. (SBU) ACP lawyers admitted to EconOff that there is no study of the legal ramifications of the expansion project. While prior toll increases were largely unnoticed, in light of the increased media attention surrounding the expansion, APEDE members expressed concerns over the possibility that governments might use the Neutrality Treaty for bargaining leverage or political gain. The Panamanian business sector is aware of this issue. One member of APEDE said in the meeting attended by EconOff, "We have to be careful. The Americans tell us not to worry about the treaty but that was their excuse for the invasion".

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Financing the Expansion  
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¶6. (U) The proposal provides that the project be paid from canal operations and increased tolls. The canal itself can neither be pledged as collateral nor serve as a guarantor. Any debt financing will be by the ACP without any GoP guarantee or obligation.

¶7. (U) The proposal provides that during construction the ACP shall remit to the GoP an amount no less than that remitted during 2006. During 2005 the ACP remitted \$488 million and is estimated to remit over \$500 million during ¶2006.

¶8. (U) Doubts about the \$5.25 billion budget exist. Former Canal Administrator Fernando Mandfredro expressed to the press that the expansion will cost at least \$7.8 billion. He says the ACP has not accounted for many additional expenses such as reinforcing the bridges to carry heavier payloads, additional navigational systems and various administrative expenses. He believes the ACP will have to borrow over \$4.6 billion not the \$2.3 billion the ACP has budgeted.

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Canal Expansion as Cure All  
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¶9. (U) The GoP claims the expansion will create 7,000 direct and 35,000 indirect jobs during the construction phase and add an additional 1% annually to GDP growth. This higher GDP growth rate will in turn result in an additional 150,000 to 250,000 new jobs. The expansion will result in 1,100 new permanent jobs at the ACP.

¶10. (U) Due to the skilled labor shortage, the GoP has begun a process to train people in the needed skills such a heavy machinery operations, masonry, plumbing and various forms of engineering. However, the limitations of this effort were seen when the GoP began receiving job applications for instructors, the majority were unqualified to teach.

¶11. (U) A former Minister of Labor expressed in the press concerns over an influx of Colombian and Dominican skilled workers and a migration of poor unskilled Panamanians from the interior to Panama City.

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COMMENT

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¶12. (SBU) While the expansion presents immense opportunity for GDP growth and job creation, if poor unemployed Panamanians witness many of the expansion jobs going to foreigners there is a potential for social unrest, particularly between Panamanians and Colombians. The GoP seems to be promising more than the canal expansion can deliver.  
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